EXHIBIT AQ

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EXHIBIT 125
WIT: Crouch
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Custodia Feedback Meeting Comments

We are meeting to provide you feedback from our September 6, 2022, Pre-membership examination. We will be providing feedback on both detailed and more broad gaps identified in risk management and the various areas we reviewed. We will highlight the key gaps as we go through our discussions. Of course, there are some caveats:

- Custodia is a de novo that is not yet operating, and some of the items we will be discussing are under development, and may have already been addressed.
- We are in a gray area here where we're not currently your supervisor but Custodia has applied to be a state member bank.
- The feedback is not comprehensive and is limited to the scope of our review, which primarily focused on imminent products and services.
    - Although we met several times related to planned digital asset related products and services, examination activities could not be conducted related to those areas.
- We would expect that the more critical gaps that we discuss be addressed prior to commencing operations as a state member. However, given the limitations in the scope and ongoing permissibility and policy questions put to Custodia by Board staff, the feedback we provide is not intended to be a complete list of items that need to be addressed in order for membership to be granted.

Talk about the other areas that we reviewed during the exam, Financial components – Capital, Earnings, Liquidity, Sensitivity to Market Risk, and Investments. No AQ. Other miscellaneous areas like insurance, Audit, ERM, Management and Risk Management.

FINANCIALS

Capital:

- Capital adequacy is difficult to measure as this is a startup company with a simple balance sheet, with significant ongoing operating costs along with Custodia's current pre-revenue status.
- Custodia management has been successful in raising $44MM in capital, and management has communicated that another $7-8MM is expected to close in mid-October.
- We noted this when we talked back in May, the regulatory capital framework for traditional banks is not adequate to measure capital adequacy for a nontraditional institution like Custodia. The crypto sprint is currently looking at capital adequacy. *I'm sure this will be an area of future conversation.*

Feedback

- *The capital planning policy states that Custodia will target the well capitalized risk-based ratios of common equity tier 1 of 6.5 percent, tier 1 risk based capital ratio of 8 percent, and total risk-based capital ratio of 10 percent. If Custodia is to comply with Regulation Q, the Capital Planning Policy should be revised to reflect the capital conservation buffer requirements (common equity tier 1 of 7.0 percent, tier 1 RBC of 8.5 percent, and total capital of 10.5 percent) to avoid restrictions on dividends and on other capital distributions, including discretionary bonus payments.*
- *Over time, risk management processes should reflect consideration of how to quantify capital requirements for Custodia's unique risk profile. This could be an area that the addition of the SVP of ERM could potentially help with. I know this is an area that you looked into as a result of our previous review.*

Earnings/Financial Projections:

- Given that the organization remains in a pre-revenue state, our review of earnings is pretty limited. We looked at the June 2022 financial projections that were included within the AI response.

- Custodia's most recent financial projections continue to show rapid product adoption and profitability. Similar to previous versions of financial projections, revenues are projected to rapidly outpace expenses in future periods and profitability is anticipated in 2023.
- It is unclear how realistic the projections are regarding quick and widespread product adoption, rapid revenue growth, and restrained expenses for years one through five. This limited review notes that absent these factors, the company will likely be required to raise capital within the first two years of operation to remain in compliance with Wyoming Division of Banking requirements.

Feedback

- *Management's financial projections show rapid and significant scaling to profitability but that is highly dependent on market/customer acceptance of products and services as well as the proposed fee structure. Management should develop additional support related to the key assumptions, specifically related to projected fee income scaling significantly faster than operating expenses. The extent the assumptions can be supported by tangible customer interest, market appetite for projected fees, and relative stability of projected expenses, that would be helpful in supporting the reasonableness of the projections.*

Liquidity

- Inherent and projected residual liquidity risks are low, given Custodia's business model, which holds highly liquid assets as reserves for customer deposits. Loans or illiquid investments are not allowed.
- Custodia has not developed detailed policies or procedures, including a contingency funding plan (CFP), liquidity risk management metrics, or comprehensive overall liquidity policy guidance.
  - While planned transactions such as withdrawals or wires out for customer accounts should simply reduce Custodia's own balance at its "correspondent" bank or master account, policies are insufficiently documented relative to handling unplanned or low-probability, high-impact liquidity stresses (one-way operational fails, unanticipated liquidity needs, etc.).
- *The board and senior management should consider creating a more comprehensive liquidity and funds management policy that incorporates tail risk events into liquidity planning, including the development of a CFP. The CFP should identify and quantify more immediate contingent sources of liquidity than raising additional capital.*
- *The board and senior management should identify liquidity metrics that are relevant to Custodia's business model and can be reported to the board of directors. Effective metrics are frequently presented in a dashboard style and can include forward-looking metrics.*

Investments

- Custodia's plans for the traditional investment portfolio present a low level of risk.
- Management decided to transfer its holdings from the Two Ocean MMA fund (BGSXX) to an Oppenheimer managed investment/cash fund.
- Investment policies are generally adequate given the planned low levels of risk. *The Investment Policy should be expanded to include more traditional risk management features, including more detailed requirements defining pre-purchase and ongoing analysis of investments and concentration limits (by investment type or characteristic and/or by broker or custodian).*

Sensitivity to Market Risk

- Traditional market risk is minimal for Custodia, given the fee-based model and lack of lending or long-term investments.
- While not traditional market risk, fees from planned digital asset custody and prime services will likely fluctuate significantly in tandem with changes in digital asset prices or volumes. Management

is well aware of this volatility and had previously prepared sensitivity analysis related to the market price of bitcoin. Custodia's bitcoin sensitivity analysis was reviewed during the December 2021, risk review but has not been updated recently.

- *If the business plan changes in a way that introduces interest rate or price risk, then policies and procedures should be enhanced accordingly.*

Pause for questions on financials.

AUDIT AND INTERNAL CONTROLS (one of the pillars of risk management)

- Custodia will outsource its planned internal audits (operational, compliance, and information technology) to RSM, and Maura will oversee the outsourced audit program.
- A business risk assessment included in the Business Plan submitted in conjunction with the membership application also serves as the risk assessment that supports the audit plan.
- Based on the risk assessment and consultation with management, RSM has proposed an audit scope covering a significant portion of the audit universe; however, a final statement of work from the vendor was not available as of the examination.
- The Audit Committee consists of four outside directors who oversee internal and external audit coverage.
- RSM conducted an external financial statement audit for the bank in 2021, and the firm has been engaged to audit the financial statements in 2022.

In addition to outsourcing Custodia's internal audit program to RSM, management has engaged the same firm to conduct the 2022 annual financial statement audit as it did in 2021. Given the apparent conflict of interest in this arrangement, RSM provided assurance to Custodia's management and the board that two separate teams within their firm would conduct the reviews and the engagement would be under separate Master Service Agreements. However, both the consulting and audit fees are paid to the same firm – RSM LLP.

SR 03-5, *Interagency Policy Statement on the Internal Audit Function and its Outsourcing,* has a provision that allows small non-public institutions with less complex operations and limited staff in certain circumstances to use the same accounting firm to perform both an external and some or all of an institution's internal audit activities. However, it is difficult to conclude that Custodia has a less complex operation, given it's planned digital asset activities. Therefore, this calls into question as to whether Custodia should qualify for the flexibility granted to small non-public depository institutions and be permitted to use the same accounting firm for both external and internal audit services. This likely isn't an issue this year, but it could be as these procedures gear up.

- *Going forward, Custodia should consider engaging a separate firm to conduct outsourced internal audits, separate from the firm engaged to complete the annual external audit of the financial statements. What we would be looking for here is a plan.*

The next items relate specifically to gaps identified within the internal audit policy.

- *The audit policy should be enhanced to address how the institution provides oversight of the outsourced internal audit service provider, conformance with the IIA Standards, the risk assessment methodology employed, and internal audit's reporting standards/expectations.*

Audit Risk Assessment

The audit risk assessments lack transparency to allow for any meaningful third-party or independent review. It is unclear how the risk factors were scored and the rationale that supports the assigned risk ratings. Additionally, the methodology includes a Relative Risk Factor that is assigned to each auditable entity by considering factors such as the results of recent audits, changes in processes or systems, changes in products, expertise in personnel and management, and complexity of the department or fu nction; however, none of that is transparent in the scoring. It is unclear whether the Relative Risk Factor score is an average of various factors considered or not, and which were considered. For example, with Wires the Relative Risk Factor assigned is 1.5 but it does not tell how that score was obtained and the specific factors that were considered.

The risk assessment and the audit program more broadly do not address what aspects of the bank's activities would be subject to continuous monitoring or auditing. Given the speed and finality of transactions the bank would be performing on behalf of customers, identifying processes and activities that would be subject to continuous monitoring or auditing is critical.

- *The risk assessment methodology and processes used to determine the audit scope should be enhanced to better define risk scoring and rationale for risk ratings.*
- *Given the speed and finality of transactions Custodia intends to perform on behalf of customers, processes and activities that would be subject to continuous monitoring or auditing should be identified.*

RSM Scope and Audit Universe

There are some inconsistencies between the draft RSM scope and the audits included on the audit universe spreadsheet. The draft RSM scope did not include any of the custody products so it is unclear whether a different vendor might be used for those audits or not. Also, there seems to be areas included in the RSM scope document that are simply not in the audit universe such as IT General Controls, and others including Positive Pay, Software Development, and Board of Directors.

- The current audit universe does not include the ERM program, and the review of insider and affiliate transactions.

Independence Standards

The board has not established and approved a set of independence standards for the audit committee members. Additionally, there is no documented evidence that each of the independent committee members have satisfied the board's independence requirements or standards. The audit committee charter refers to the board's independence standards in the Board's Supervision Policy, but no such standards were evident in that policy.

- *The board should establish and approve independence standards for members of the audit committee and document evidence that independent committee members have satisfied those standards.*
- In that regard, Custodia might be best served to adopt the more formal language contained in the IIA's Model Audit Committee Charter.

General audit reporting recommendation:

- *Management should develop an exception tracking tool and related audit committee or board reporting mechanism for monitoring the status and remediation efforts related to audit, independent review, and regulatory findings.*

Pause for Questions on Audit

Enterprise Risk Management

- The ERM program is in the early stages of development and some elements of the risk management framework have yet to be implemented.
- Custodia does not currently have a dedicated senior officer to competently develop and effectively lead its enterprise risk management program.
- An ERM Committee has been formed that will have direct responsibility ensuring that there are processes in place to assess, understand, mitigate, and monitor Custodia's enterprise risks.
- Just recently formed prior to the exam and currently chaired by Information Security Officer Ben Bauder until a senior vice president of ERM is hired to lead the Custodia's program.

Feedback – This are items that can be addressed over time.

Although management and the board have developed broad RAS, the *qualitative descriptions of risks are not defined* nor supported *with any risk metrics such as key risk indicators*. For example, the board's residual risk appetite for Market Risk is simply stated as Moderate; however, senior management has yet to identify the critical risk measures that would be evaluated along with relevant risk limits. In the absence of such quantitative measures, one cannot distinguish between a moderate and a high level of risk. In effective risk management programs, risk appetite statements are normally driven by management and the board's consideration of a firm's risk capacity (the maximum amount of risk an entity can withstand/absorb), risk targets or ranges, and risk profile (could be based on industry or competitors).

- *Although management and the board have developed broad risk appetite statements, the qualitative descriptions of risks are not defined nor supported with any risk metrics such as key risk indicators.*

- *The risk assessment rating scales are not defined and lack transparency to allow for a repeatable process, allow for third party or audit review of the process, and limit risk aggregation. Typically, there are well-defined measurement scales for likelihood, impact, and overall inherent risk rating.*
- *The bank does not have an inventory of all enterprise risk assessments that would be completed to support the ERM program. Glaring areas/processes without risk assessments include information technology, vendor management, Fraud, E-Banking, and Human Resources.*
- *Critical risk metrics or key risk indicators to support enterprise risk reporting have not been established.*
- *Enterprise-wide risk reporting has not been developed.*

Operational Risk Management. Given the potential significance of operational risk for an institution whose primary activity is digital assets, the value and volume of transactions could be significant,

consequently the inherent operational risk is high. To help manage Custodia's operational risk, developing a comprehensive operational risk management program would be beneficial to the board. While the bank is not subject to Basel II, that framework provides a useful process for developing an effective operational risk management program.

Pause for Questions on ERM

DIGITAL ASSETS

- Digital asset products are in development with limited formalized risk management currently available for review.
- While management's new-product-development timelines are relatively short-term, planned digital asset custody, Avit, and prime services remain in development, and in some areas, the conceptualization phase.
- An overview of Custodia's broad project management process was provided to examiners. If executed as described, this approach is reasonable; however, it does not yet appear to have been executed as described, particularly as it relates to the risk assessment process. Detailed project management documentation related to planned digital asset products and services was not reviewed during this examination.
- Policies and procedures related to planned digital asset activities have not yet been drafted.
- Formalized risk assessments for planned products and services are outdated or have not yet been completed, and the methodology is not yet well defined and supported. Initial risk assessments for Avit and Custody were prepared in December of 2021, and a risk assessment has not yet been completed for Prime Services. Management presentations provided to examiners noted that the intention is for risk assessments to be conducted and updated iteratively throughout the product development process; however, that process has not yet occurred. *Management noted that the candidate filling the opening for the SVP of Enterprise Risk Management would assume the responsibility for these risk assessments, which would be reviewed by the Enterprise Risk Management Committee.*
- The anticipated customer base has not yet been provided in detail

Areas for future review – Digital Assets

- *Examiners should request and review the customer agreements and disclosures for the various planned digital asset products and services.*
- *Examiners should review completed/updated risk assessments and related processes as well as the documentation of developed controls for the various products and services throughout the development process, pre and post product launch.*
- *Examiners should review relevant policies and detailed procedures for planned products and services as they are developed.*
- *Examiners should assess testing and independent review of products and services and related controls completed and documented prior to and post engaging in the planned digital asset and related activities.*

Stop there before we get into Management – Caitlin – I wasn't sure if you planned to have your whole team on for this portion of the call.

MANAGEMENT AND RISK MANAGEMENT

Board and Senior Management Oversight

- The overall effectiveness of board and senior management remains difficult to determine as Custodia has yet to commence operations.

- The board is active and generally meets on a biweekly cadence with board meetings continuing to cover what would likely eventually be handled by the planned committee structure.
- Custodia's board, executives, and staff come from a variety of backgrounds, which are largely technology related.
    - CEO Long stated that the bank look to add two additional board members after a potential Series B stock issuance.

Policies, Procedures, and Risk Limits

- Currently policies, procedures and risk limits are not as developed as what would be expected for an operating traditional bank, most notably in the areas of BSA/AML and OFAC compliance and IT.
- There were gaps that were identified across all areas reviewed, acknowledge that management has identified gaps as well and are working on this area
- **In general, policies, procedures and risk limits are vague and not always tailored to Custodia's unique business model and planned activities.**
- **Risk limits are not yet fully developed.**
    - Given BSA officer turnover, it is important that the procedures and process be adequately formalized so that they can stand up on their own.

Risk Monitoring and Management Information Systems

- Talked about ERM
- Routine board reporting including the development of key measures that would be monitored by management when Custodia begins operating has not yet been developed/provided

Audit and Internal Control

Hold off on this point until Maura is off of the call

Feedback

- *Custodia should designate a competent and independent audit manager to oversee the outsourced internal audit program. EIC Crouch note – the addition of an SVP of ERM could assume this role as a stopgap until the sophistication of operations warrant the addition of an audit manager.*
    - The Bank has outsourced all its internal audits (operational, compliance, and information technology) to RSM US LLP, Chicago, Illinois (RSM), and the program will be managed by Chief Compliance Officer (CCO) Maura Liconte, who joined Custodia in July 2022. In assigning oversight of the outsourced audit program to the CCO, management and the board have concluded that delegating the role to any other managers or officers would present a conflict of interest.
    - Under Supervision and Regulation (SR) Letter 03-5, *Interagency Policy Statement on the Internal Audit Function and its Outsourcing*, the general principle is that outsourced internal audits are *typically* under the control of the <u>institution's manager of internal audit</u>, and the outsourcing vendor reports to him or her. The guidance allows for *small institutions* that do not employ a full-time audit manager to appoint a competent employee who ideally had no managerial responsibility for the areas being audited to oversee the outsourcing vendor's performance. It seems that given the *novel and complex nature of Custodia's activity (digital assets)*, the prudent course of action should

be to have a competent audit manager who would oversee the outsourced internal audit program.

Some Broad feedback

However, the depth of banking experience and bank-specific risk management experience among the board and bank management team appears limited.

Acknowledge the summary bios that were provided – that is helpful.

Formality of developed procedures – regulatory expectations – Ben's comments regarding the chicken or the egg – relative to risk assessments and interplay with the development of controls.

- This review identified key gaps in the areas of risk management, BSA, and information technology, the root cause of which may need to be addressed through the building of depth at the board, management, and staff level.
- Custodia is looking to hire an SVP of enterprise risk management that could help in this capacity. However, the ability and effectiveness of a potential new hire to enhance risk management practices and the culture of the organization remains to be seen.

- *Management should continue to evaluate depth of banking and regulation specific expertise across all risk stripes and all levels of the enterprise as they look to scale as Custodia grows.*
- *The succession plan should more precisely identify the actions taken in case they lost the BSA officer/Chief Compliance Officer, Director of Information Security in the short and long term.*

Letter – send responses but we will need to go in and review later.